

DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 99-0571

Sales Tax

For Tax Periods 1996-1998

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superceded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Sales Tax—Over-Rings and Gross-Up

Authority: IC 6-8.1-5-1; IC 6-8.1-5-4

Taxpayer protests the methods used by the auditor to estimate the assessment in the absence of records.

II. Tax Administration—Interest

Authority: IC 6-8.1-10-1

Taxpayer protests the imposition of interest.

III. Tax Administration—Fraud Penalty

Authority: 45 IAC 15-5-7

Taxpayer protests the imposition of a 100% Fraud Penalty.

STATEMENT OF FACTS

Taxpayer operates a tavern selling familiar name brand liquor, beer and wine. The Indiana Department of Revenue conducted a sales tax audit for the years 1996, 1997 and 1998. Taxpayer protested the resulting assessments, interest and penalties, while offering no supporting documentation. Taxpayer's representative (Power of Attorney (POA) on file) waived the administrative hearing. Taxpayer then appeared for the hearing, and the hearing officer rescheduled the hearing to provide time for taxpayer and the POA to communicate with each other. The hearing officer also suggested that the taxpayer make copies of any records the Department should consider and send them in prior to the

hearing. Taxpayer called approximately three weeks before the hearing, to say that the records were in the mail. The Department of Revenue never received the records. This Letter of Findings is written based on the information contained in the file.

I. Sales and Use Tax—Over-Rings and Gross-Up

DISCUSSION

Taxpayer protests the method used by the auditor to determine the assessments. Taxpayer failed to keep complete records as required by IC 6-8.1-5-4(a), which states:

Every person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records.

Due to the lack of complete records, the auditor had to estimate some of the assessment. The auditor made the proposed assessment pursuant to IC 6-8.1-5-1(a), which states in part:

If the department believes that a person has not reported the proper amount of tax due, the department shall make a proposed assessment of the unpaid tax on the basis of the best information available to the department.

IC 6-8.1-5-1(a) also states:

The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid, and the burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made.

Taxpayer has protested the results of the audit, but has provided no evidence to support that protest. Taxpayer protests that the auditor did not allow for over-rings. The auditor's Explanation of Adjustments, form AD-9, states that for the months which had to be estimated, the auditor adjusted down the daily totals for obvious over-rings.

Taxpayer protests the use of the number three as a gross-up factor, and believes that use of the number two or lower would be more appropriate. The auditor explained that Department practice in cases where taverns lack adequate records is to "gross-up" the taxpayer's revenues based on the taxpayer's cost of goods sold. The cost of goods sold is multiplied by a factor of two to seven, depending on the circumstances of the case. The resulting number is considered to be the taxpayer's revenues. The auditor held a factor of three to be sufficient to protect the interests of the state in this case. Given that the factor could have been as high as seven, and that the Department was unable to review accurate records as required by statute, the use of three as a factor in this case is reasonable and appropriate.

FINDING

Taxpayer's protest is denied.

II. Tax Administration—Interest

DISCUSSION

Taxpayer asked the Department to reduce some of the interest associated with these assessments. IC 6-8.1-10-1(e) states:

Except as provided by IC 6-8.1-5-2(d)(2), the department may not waive the interest imposed under this section.

IC 6-8.1-5-2(d)(2) refers to the suspension of interest when an extension agreement is reached between a taxpayer and the Department. There was no such agreement in this case. Therefore, IC 6-8.1-5-2(d)(2) does not apply, and the Department may not waive the interest associated with these assessments.

FINDING

Taxpayer's protest is denied.

III. Tax Administration—Fraud Penalty

DISCUSSION

Taxpayer asked the Department to waive some or all of the one hundred percent (100%) fraud penalty imposed along with these assessments. In establishing the fraud penalty, IC 6-8.1-10-4 provides:

- (a) If a person fails to file a return or to make a full tax payment with that return with the fraudulent intent of evading the tax, he is subject to a penalty.
- (b) The amount of the penalty imposed for a fraudulent failure described in subsection (a) is one hundred percent (100%) multiplied by:
 - (1) the full amount of the tax, if the person failed to file a return; or
 - (2) the amount of the tax that is not paid, if the person failed to pay the full amount of the tax.
- (c) In addition to the civil penalty imposed under this section, a person who knowingly fails to file a return with the department commits a Class A misdemeanor.
- (d) The penalty imposed under this section is imposed in place of and not in addition to the penalty imposed under section 2 of this chapter.

45 IAC 15-5-7(f)(3) provides that there are five elements to fraud, by stating:

A person who files a return which makes a false representation(s) with knowledge or reckless ignorance of the falsity will be deemed to have filed a fraudulent return. There are five elements of fraud.

- (A) Misrepresentation of a material fact: A person must truthfully and correctly report all information required by the Indiana Code and the department's regulations. Any failure to correctly report such information is a misrepresentation of a material fact. Failure to file a return may be a misrepresentation.
- (B) Scienter: This is a legal term meaning guilty knowledge of a state of facts, such as evasion of tax, which it was a person's duty to guard against. A person must have actual knowledge of the responsibility of reporting the information under contention. However, the reckless making of statements without regard to their truth or falsity may serve as an imputation of scienter for purposes of proving fraud.
- (C) Deception: Deception operates on the mind of the victim of the fraud. If a person's actions or failure to act causes the department to believe a given set of facts which are not true, the person has deceived the department.
- (D) Reliance: Reliance also concerns the state of mind of the victim and is generally considered along with deception. If the person's actions, failure to act, or misrepresentations cause the department to rely on these acts to the detriment or injury of the department, the reliance requirement of fraud will be met.
- (E) Injury: The fraud instituted upon the department must cause an injury. This can be satisfied simply by the fact that the misrepresentation(s) caused the department not to have collected the money which properly belongs to the state of Indiana.

In order to demonstrate fraud, the department is required to prove all of the above elements are present. This must be shown by clear and convincing evidence.

In this case, all five elements are present. Misrepresentation of a material fact is present due to the fact that taxpayer failed to correctly report all information required by the Indiana Code and the Department's regulations. Scienter is present due to the fact that taxpayer signed twenty-seven (27) ST-103 forms during this period and had actual knowledge of the responsibility of reporting actual sales. The caption on form ST-103 states, "I [taxpayer] declare under penalties of perjury that this is a true, correct and complete voucher." The audit showed that the vouchers were not true, correct and complete.

Deception is present due to the fact that the Department had no reason to believe that the statements made by taxpayer, which were shown in the audit to be false, were not true. Reliance is present due to the fact that the Department relied, to its detriment, on the statements made by the taxpayer. Injury is present due to the fact that the Department was unable to collect the money which rightfully belonged to the state of Indiana. There

is clear and convincing evidence that all five elements of fraud are present, therefore the penalty is appropriate.

FINDING

Taxpayer's protest is denied.

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